STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company	:	
	:	07-0566
Proposed general increase in electric rates	:	
(Tariffs filed October 17, 2007)	:	

DISSENTING OPINION OF COMMISSIONERS ROBERT F. LIEBERMAN AND SHERMAN J. ELLIOTT, FROM THE ORDER ENTERED BY THE COMMISSION ON SEPTEMBER 10, 2008

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The Majority's decision to reject netting accumulated depreciation of existing embedded plant against pro forma additions to gross plant in the post-test year period from January 1, 2007 to June 30, 2008, misapplies the rule for pro forma adjustments (Ill. Admin. Code tit. 83, §287.40), misinterprets the 02-0098/03-0008/03-0009 Order, relies on previous cases that are based on faulty rationale, provides the wrong incentive to utilities and is in direct conflict with most intervening parties positions on the issue. The Majority failed to account for the accumulated depreciation of existing embedded plant in the post-test year period. In effect, it allows the mismatch of gross plant additions through second quarter 2008 with the accumulated depreciation balance for the end of 2006, thus violating the matching principle – balancing expenses and revenues – a basic tenet of ratemaking. While the Commission has allowed this treatment in previous cases, it is contrary to the allowable adjustments in Section 287.40. The decision is also contrary to the Commission's test-year rule. "The purpose of the test year rule is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year."[1] Further, this mismatch lowers the accumulated depreciation balance and results in higher net plant, an inflated rate base, and therefore, rates that are not just and reasonable. The overstated rate base results in a revenue requirement[2] that exceeds ComEd's needs by just over 3.75%[3].

1 Business & Professional People in the Public Interest v. ICC, 146 Ill. 2d 175, 238 (Ill. 1991) ("BPI II").

2 The revenue requirement formula is:
Revenue Requirement = (Operating Expenses) + [(Return) x (Rate Base)]
(*See, e.g.,* AARP Ex. 1.0 at 10).

3 The Majority's decision increases rate base by $561.004 million, which increases the revenue requirement by $78.415 million, and is 3.75% of the total revenue requirement approved in the 07-0566 Order ($78.415M/$2090.068M (Total Operating Revenues from Appendix)).

Accordingly, we respectfully dissent from the Order's conclusions and rationale regarding IV.C.2(i) *Accumulated Provisions for Depreciation and Amortization*[4] and the corollary issue of IV.C.2(ii) *Accumulated Deferred Income Taxes ("ADIT")*.[5]

I. BACKGROUND

Section 287.40 Pro Forma Adjustments to Historical Test Year Data states:

> A utility may propose pro forma adjustments (estimated or calculated adjustments made in the same context and format in which the affected information was provided) to the selected historical test year for all known and measurable changes in the operating results of the test year. These adjustments shall reflect changes affecting the ratepayers in plant investment, operating revenues, expenses, and cost of capital where such changes occurred during the selected historical test year or are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable. Attrition or inflation factors shall not be substituted for a specific study of individual capital, revenue, and expense components. Any proposed known and measurable adjustment to the test year shall be individually identified and supported in the direct testimony of the utility. Each adjustment shall be submitted according to the standard information requirement schedules prescribed in 83 Ill. Adm. Code 285.[6]

In calculating its rate base, ComEd included plant and accumulated depreciation for the test year[7], and also included pro forma adjustments for plant additions and the related accumulated depreciation and deferred taxes for the post-test year period.[8] ComEd filed its tariffs requesting a rate increase on October 17th, 2007. Per 287.40, changes that are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable may be considered by the Commission. Twelve months from that filing date was approximately the end of the third quarter of 2008 (September 30th). In its initial testimony, ComEd explained that the pro forma capital additions to rate base were additional plant projects that had been placed into service in 2007 or were reasonably expected to be placed into service by the end of the third quarter of 2008.[9] Of specific interest, is that ComEd's increase in accumulated depreciation from December 31, 2006 to June 30, 2008 relates only to the new, pro forma plant additions

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4 Order at 27-30, 51.
5 *Id*. at 32, 51.
6 Ill. Admin. Code tit. 83, §287.40.
7 The approved test year is January 1, 2006 to December 31, 2006. (Order at 5, 235).
8 ComEd Ex. 7.0 Corr. at 18, 34-36; ComEd Ex. 7.1, Sched. B-1 at 1:8, col. (d), Sched. B-2 at 1, cols. (B) and (C), Sched. B-2.1; ComEd Ex. 7.2, Work Papers WPB-2.1a, WPB-2.1b.
9 ComEd Ex. 7.0 at 35.

and fails to account for the accumulated depreciation of existing embedded plant that accrues over this period.

ComEd reduced its rate base proposal in its rebuttal and surrebuttal testimonies. The reduction was attributed to ComEd's acceptance of adjustments proposed by both Staff and Intervenors.[10] ComEd's final rate base proposal was presented in its surrebuttal testimony -- $6,752,566,000 (which includes $1,334,607,000 of plant additions through June 30, 2008[11])[12]. In addition to the adjustments made in rebuttal testimony, this amount accounts for the resolution of issues stated in a ComEd-Staff joint stipulation[13, 14] ("Stipulation"), in which parties agreed to, among other things, the post-test year period for pro forma adjustments being 18 months (*i.e.*, reducing the end date of the period from September 30, 2008 to June 30, 2008).

The methodology used in the Stipulation for determining the amount of net increase in plant in the post-test year period does not vary from what ComEd proposed in its testimony. In rebuttal testimony, Mses. Houtsma and Frank stated "ComEd included in its rate base calculations the annual increase in Accumulated Depreciation that is directly related to its proposed *pro forma* plant additions."[15] ComEd relies upon this testimony to support the Stipulation's treatment of accumulated depreciation.[16]

Not all of the parties or intervenors in the case joined the Stipulation, therefore, the Majority conducted a BPI[17] analysis – evaluating the Stipulation based on the law and the evidence in the record on this issue. In evaluating the facts, the Majority held that the instant case is factually distinguishable from Docket 02-0798/03-0008/03-0009 because ComEd's net plant is increasing. However, the Majority failed to account for the accumulated depreciation on existing embedded plant in the post-test year period.[18]

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10 ComEd Ex. 25.0 Corr. at 3; ComEd Ex. 25.01, Sched. B-1.
11 Order at 16, 28.
12 ComEd Ex. 40 Corr. at 3; ComEd Ex. 40.01 Sched. RB-1, cols. (H) & (K).
13 *Stipulation Concerning Incorporation of Certain Adjustments from the Original Cost Audit and Resolution of Certain Revenue Requirement and Other Issues*, ComEd/Staff Joint Ex. 1, filed April 10, 2008.
14 ComEd proposed, that in the event the Stipulation was not accepted by the Commission, ComEd's rate base should be $6,951,006,000. (ComEd Ex. 40.01, Sched. RB-1, col. (H); Order at 6)
15 ComEd Ex. 25.0 at 23-25.
16 Stipulation at 6, ¶II.8.
17 Business & Professional People for the Public Interest v. ICC, 136 Ill. 2d 192, 209-10 (Ill. 1989), *citing* Mobil Oil Corp. v. Federal Power Comm'n, 417 U.S. 283, 313 (US 1974).
18 Order at 29, 30.

II. ARGUMENTS

A. The Order does not correctly apply the "All Known and Measurable Changes" Provision of the Commission's Rules on *Pro Forma Adjustments to Historical Test Year Data* (Ill. Admin. Code tit. 83, §287.40)

The Illinois Industrial Energy Consumers ("IIEC"), the People of the State of Illinois ("AG") and Citizen's Utility Board ("CUB") each clearly explain that the "all known and measurable changes" includes accumulated depreciation on existing embedded plant in the post-test year period ("net plant"), and failing to adjust rate base with net plant is improper.[19] To expand upon their explanations, we interpret Section 287.40 to require all known and measurable changes that impact the operating results to be accounted for in rate base.[20] Section 287.40 defines the manner in which pro forma adjustments are to be made, and states:

> A utility **may** propose pro forma adjustments (estimated or calculated adjustments made in the same context and format in which the affected information was provided) to the selected historical test year for **all known and measurable changes in the operating results** of the test year. **These adjustments shall reflect changes** affecting the ratepayers **in plant investment, operating revenues, expenses, and cost of capital** where such changes occurred during the selected historical test year or are **reasonably certain to occur** subsequent to the historical test year **within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable**. Attrition or inflation factors shall not be substituted for a specific study of individual capital, revenue, and expense components. Any proposed known and measurable adjustment to the test year shall be individually identified and supported in the direct testimony of the utility. Each adjustment shall be submitted according to the standard information requirement schedules prescribed in 83 Ill. Adm. Code 285.[21]

The rule clearly states that a utility does not need to make pro forma adjustments, but can make such adjustments either within the test year or within 12 months after filing of tariff changes with the Commission. The instant issue before the Commission is the latter, evaluating pro forma adjustments proposed for the period after the test year. Careful reading of the rule reveals, in such an instance, pro forma adjustments shall reflect "all known and measurable changes," "where the amounts of the changes are determinable" and are "reasonably certain to occur" for changes in plant investment,

[19] *See*, IIEC Initial Brief at 9-13, 17; Reply Brief 8-9; *see also*, AG Initial Brief at 7-8; Reply Brief at 4; *and* CUB Initial Brief at 6-7; Reply Brief at 2-3.

[20] Interpretation supported by CUB in its Reply Brief at 2.

[21] Ill. Admin. Code tit. 83, §287.40)(emphasis added).

operating revenues, expenses, or cost of capital that affect the ratepayers. Accumulated depreciation for existing embedded plant clearly meets these requirements and should have been carried forward and applied to offset the post-test year plant additions proposed by ComEd.

Accumulated depreciation is known and measurable and can be determined. Accounting is a double entry (recording) system -- recording debits and credits (*i.e.*, debits = credits). The recording of depreciation expense affects two accounts: depreciation expense and accumulated depreciation; you cannot record depreciation expense (*i.e.*, the debit) without also recording accumulated depreciation (*i.e.,* the credit). When depreciation expense is recorded there is also a recognition or recording of accumulated depreciation.[22] Accumulated depreciation is used to reduce the rate base for that portion of plant investment and net salvage already recouped through rates.[23] Therefore, if depreciation expense is *known and measurable*, then accumulated depreciation is also *known and measurable*.

In making decisions on individual issues that shape rate base, the Commission must keep in mind that the test year revenue requirement reflects the companies' revenue needs in the future; when the rates are in place. This is supported in the Bender Series where it is noted, "pro forma additions are the restatement of test year events or conditions to measure future conditions more accurately."[24] The Bender series further acknowledges the need for accurate forecasts of future conditions, stating that "the test period is a surrogate for conditions of the period of rate use and is presumed to be representative of future conditions."[25] In looking at pro forma adjustments to depreciation, the Bender Series instructs us that:

> Pro forma adjustments are often made to the depreciation provisions recorded during the rate case test period. The adjustments are made to provide rate case revenue requirements that reflect the costs expected to be incurred during the period of time the service rates will be in effect. The adjustments are made to recognize higher levels of depreciable investment than those reflected in recorded depreciation and to recognize depreciation rate revisions.[26]

Therefore, to the extent that rate expenses can be determined so can, and should, accumulated depreciation.

The Majority's disregard for compelling testimony and the Orders' resulting failure to record accumulated depreciation on existing embedded plant in the post-test year

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[22] IIEC Ex. 2.0 at 57; *see also*, IIEC Initial Brief at 9-10.
[23] Matthew Bender Series, Accounting for Public Utilities, Rel. No. 23, at 4-15 (Oct. 2006) ("Bender Series").
[24] *Id*., at 7-5.
[25] *Id*., at 7-11.
[26] *Id*., at 6-41.

period provides a windfall that is reflected in ComEd's revenue requirement. Generally stated, the accounting principle of test year matching "requires a company to **match expenses with related revenues** in order to report a company's profitability during a specified time interval."[27] The Commission has previously and correctly acknowledged this as one of its responsibilities when it stated: "[t]he regulatory basis for adopting a test year is to ensure that the rates established are reflective of costs and revenues that may be expected for the period during which such rates are in place."[28] Section 287.40 also reflects the matching principle by requiring the accounting of all known and measurable changes to plant investment, which, as discussed above, includes accumulated depreciation. The matching principle for accumulated depreciation is supported in the Bender Series, in which it is explained that the reserve balance is to be accounted over the same period as that used for plant in service[29]:

> Deduction of the reserves accumulated for annual depreciation and amortization charges from a utility's rate base is an accepted principle of rate base development, **with the reserve balances [accumulated depreciation for embedded plant] generally calculated on the same basis as that used for determining rate base plant in service**.[30]

The Bender Series also explains that:

> Theoretically, the accumulated reserves [depreciation] have been collected from utility customers through the cost of service treatment for depreciation and the resulting revenue requirements generated. Deducting accumulated reserves [depreciation] from the rate base prohibits the utility from earning a further return on costs that have been recovered . . . [31]

Thus, had the Majority deducted the accumulated depreciation for existing embedded plant in the post-test year period, ComEd would not have earned a further return on the additional plant it included in the pro forma adjustments. Instead, the Majority's failure to deduct that accumulated depreciation results in a test year mismatch of 2008 gross plant (ending on June 30, 2008) with 2006 accumulated depreciation on existing embedded plant (based on the test year, ending December 31, 2006)[32]; therefore, allowing ComEd to recover a windfall through its overstated rate base. This is achieved through an increase to rate base equal to the amount of

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[27] Dictionary of Accounting Terms for "matching principle": http://www.accountingcoach. com/accounting-terms/accounting-dictionary/accounting-terms-M.html)(emphasis added);*see also*, AG/CUB Ex. 2.0 at 19; AG Initial Brief at 9-10; IIEC Initial Brief at 10-13, 17.

[28] *Central Illinois Public Service Company (AmerenCIPS) and Union Electric (AmerenUE), et. al,*, Dockets 02-0798/03-0008/03-0009(cons.) at 10 (Oct. 23, 2003).

[29] In this case, ComEd has requested, and the Commission has approved, that period be January 1, 2006 to June 30, 2008.

[30] Bender Series at 4-15 (emphasis added).

[31] *Id*.

[32] *See*, IIEC Initial Brief at 9-11, 14, 17.

accumulated depreciation that has accrued from December 31, 2006 to the end of the test period in which ComEd is accounting for additional plant – June 30, 2008 – but was not deducted. Thus, ComEd's rate base in the Order reflects the December 31, 2006 accumulated depreciation balance related to existing embedded plant, which is lower than the June 30, 2008 accumulated depreciation balance should be, had the depreciation been brought forward. This results in ComEd over-recovering on its increase to rate base from September 16, 2008 (the effective date for tariffs filed in compliance with Order 07-0566) until such time as new tariffs are filed in compliance with the next rate case order.[33]

B. The Majority Improperly Limits the Application of the 02-0798/03-0008/03-0009 Order's Decision to Cases in Which Net Plant is Not Increasing

The Majority embraces the logic applied in the 05-0597 and 07-0241/07-0242 Orders and distinguishes the application of the 02-0798/03-0008/03-0009 Order in the instant Order. In distinguishing the 02-0798/03-0008/03-0009 Order the Majority incorrectly holds that the decision in that case only applies when net plant is flat or decreasing. The Majority erred because the accounting of "all known and measurable changes" requires the use of net plant in all instances and not the use of gross plant. While the rule applied in Docket 02-0798/03-0008/03-0009 (Ill. Admin. Code tit. 83, §285.150(e) (2002)) was changed to its current form in August 2003 (*i.e.*, §287.40), in that case the Commission evaluated the pro forma adjustments using net plant to the end of the post-test year period. Such an analysis was, and continues to be, consistent with the matching principle (*supra*, at 1 and §II.A. at 6) and is consistent with the "all known and measurable changes" requirement of the current rule (§287.40).

In Docket 02-0798/03-0008/03-0009[34] the AG proposed two instances in which post-test year capital additions should be allowed into rate base -- when there is a demonstrated trend of increases in net plant in service or when there is a "significant" instance in which net plant was positive.[35] The Commission relied upon this analysis in reaching its decision in that case.[36]

In Docket 02-0798/03-0008/03-0009 AmerenUE and AmerenCIPS requested pro forma adjustments for "significant" capital additions made in the twelve months after the test year. The Commission denied recovery of the adjustments for AmerenCIPS but granted it for AmerenUE. The Commission's decisions for both companies were in-line with the principles espoused in Section II.A., above.

[33] *See*, IIEC Initial Brief at 20-21; *see also*, *infra*, §II.D., *providing* an example of the effect on rate base of not accounting for accumulated depreciation of embedded plant in the post-test year period.
[34] The pro forma rule has been amended since Docket 02-0798/03-0008/03-0009; replacing "shall reflect significant changes" with "shall reflect changes affecting the ratepayers."
[35] 02-0798/03-0008/03-0009 Order at 9.
[36] *Id*. at 10.

In Docket 02-0798/03-0008/03-0009 AmerenCIPS included in its pro forma capital additions four specific projects[37] that occurred in the twelve months after filing of the revised tariffs.[38] The Commission denied the pro forma adjustments related to these projects because they "would result in a mismatch of costs and revenues that may be expected for the period during which rates are in place. Due to the circumstances presented here it would result in an overstatement of rate base."[39] Stated another way, the $2,291,000 of plant additions are completely offset by the increase in accumulated depreciation and amortization ($8,263,000).[40] Therefore, Ameren's proposed adjustment would have resulted in an overstatement of rate base. Thus, the pro forma adjustments for the post-test year capital additions were disallowed.

In Docket 02-0798/03-0008/03-0009 the Commission approved AmerenUE's pro forma adjustment because "the post-test year additions to plant exceed the post-test year increase in accumulated depreciation."[41] Staff and AG presented evidence showing a four year trend (from 1998 through 2001) of increasing net plant.[42] The Commission adjusted rate base by the amount of net plant (*i.e.*, pro forma adjustment minus the increased accumulated depreciation[43]) which resulted in an increase of $785,000.[44] CUB points out that AmerenUE's situation is similar to ComEd's situation in the instant case.[45]

In the instant case, the Majority improperly limits the application of the 02-0798/03-0008/03-0009 Order to cases in which net plant is **not** increasing.[46] As the foregoing discussion shows, evidence was presented that AmerenUE experienced a four year trend of increasing net plant. If accumulated depreciation for embedded plant in the post-test year period was not to be included in rate base when there was a trend of increasing net plant then the Commission would not have allowed it under these facts. Therefore, it is improper for the Majority to state that the 02-0798/03-0008/03-0009 Order is distinguishable from Dockets 01-0423, 05-0597 and 07-0241/07-0242 on a "fact pattern" that they all share.[47] In its brief, CUB correctly identifies that the principle of accounting for accumulated depreciation on existing embedded plant in the post-test year period is applied in the same manner to both AmerenUE and AmerenCIPS, regardless of the net plant being positive or negative, as well it should be to reflect the test year matching principle.[48]

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[37] Pro forma plant additions can be attributed to specific, identifiable plant addition projects or blanket projects. Specific projects are supported by documentation, whereas blanket projects are allowable because they are below a certain dollar level. (ComEd Ex. 4.0 (2d Corrected) at 39, 43)

[38] 02-0798/03-0008/03-0009 Order at 7.

[39] *Id*. at 10.

[40] *Id*.

[41] *Id*. at 10.

[42] *Id*. at 8.

[43] AG Initial Brief in Docket 02-0798/03-0008/03-0009 at 2 (July 28, 2003).

[44] 02-0798/03-0008/03-0009 Order at 10.

[45] CUB Initial Brief at 6.

[46] Order at 29, 30.

[47] *See*, Order at 29, 30, *stating* that these cases are distinguishable.

[48] CUB Initial Brief at 6-7.

Moreover, the decision in the 02-0798/03-0008/03-0009 Order is consistent with the "all known and measurable in the operating results of the test year" language in Section 287.40. The rule requires the accounting of all known and measurable changes, which in effect is the evaluation of net plant. Net plant is to be used in all instances because the rule does not limit the all known and measurable requirement to instances when net plant is increasing, decreasing or flat.

Thus, the Majority erred in classifying the 02-0798/03-0008/03-0009 Order to be applicable only in cases where net plant is **not** increasing. The decision in Dockets 02-0798/03-0008/03-0009 is consistent with Section 287.40 and the accounting principles, discussed above and is the appropriate precedent to guide us. Whether net plant is increasing or decreasing is irrelevant. The evaluation of net plant, as applied in the 02-0798/03-0008/03-0009 Order, ensures proper matching of test year revenues and expenses, and prevents a windfall for the utility.

C. The Decisions, to Deny Accounting of Accumulated Depreciation of Embedded Plant in the Post-test Year period, in Dockets 01-0423, 05-0597 & 07-0241/07-0242 Are Based on Faulty Rationale

Instead of applying the plain language of Section 287.40 and the principles used in the 02-0798/03-0008/03-0009 Order, the Majority relies on decisions the Commission reached in other cases (*i.e.*, Dockets 01-0423, 05-0597 and 07-0241/07-0242).[49] None of the Orders the Majority relies upon correctly apply Section 287.40.

In the 01-0423 Order the Commission accepted Staff's adjustment to additional plant in service.[50] Staff proposed a reduction for accumulated depreciation related to the additional plant in service. The Commission did not increase the accumulated depreciation for existing embedded plant for the post-test year period, as proposed by the Government and Consumer Intervenors[51] ("GCI"). Therefore, the conclusion in Docket 01-0423 is similar to what was decided in the instant case. In rejecting GCI's proposal the Commission placed its reliance on ComEd's rationale – accumulated depreciation for embedded plant would improperly shift the test year[52].

GCI's proposal in Docket 01-0423 was **not** an improper shifting of the test year. Accounting for accumulated depreciation of existing embedded plant in the post-test year period provides for the matching of expenses and revenues.[53] Failing to account for accumulated depreciation for existing embedded plant during the post-test year period is improper for the reasons explained above. Briefly summarized, it ignores the "all known and measurable changes" language in Section 287.40; it is contrary to

[49] Order at 30.

[50] 01-0423 Order at 45.

[51] The AG, the City, CCSAO, and CUB referred to themselves as the "Government and Consumer Parties" or "Government and Consumer Intervenors ("GCI").

[52] ComEd also argued that it applied the correct annual depreciation rates, however, that argument has no bearing on the issue being addressed in the dissent. (01-0423 Order at 44-45)

[53] *See, supra*, §II.A.

accepted accounting practices regarding matching test year expenses and revenues and therefore allows the utility to receive a windfall.[54]

In the 05-0597 Order, the Commission again accepted ComEd's interpretation of Section 287.40 instead of the AG's position. The AG's position was consistent with the Commission's decision on this issue in the 02-0798/03-0008/03-0009 Order. Similar to ComEd's actions in the instant case, ComEd proposed to account for accumulated depreciation of the existing embedded plant in the test year, but not beyond the test year. Beyond the test year, ComEd only accounted for the depreciation of the additional plant. In reaching its decision the Commission concurred with ComEd's arguments that the AG's proposal violates Section 287.40. In support of this position ComEd proffered two arguments[55]: ComEd only has "a finite number of pro forma plant additions" and therefore it does not warrant the restatement of accumulated depreciation for all plant in service into the post-test year period; and accounting for accumulated depreciation for embedded plant in the post-test year period is an adjustment for attrition, and such adjustments are prohibited by Section 287.40.[56] Looking back at these arguments, we find them to be contrary to the "all known and measurable changes" requirement of Section 287.40.

While ComEd's first argument is not entirely clear, it implies that the AG's proposal is a mismatch of accumulated depreciation for existing embedded plant to the pro forma adjustment for additional plant. The flaw in this argument is that Section 287.40 requires the pro forma adjustment to include "all known and measurable changes" that impact operating results, which includes accumulated depreciation for existing embedded plant.[57] Another possible interpretation of ComEd's statement is that ComEd may have intended that its pro forma adjustment was a subset of all the plant additions ComEd was performing in the post-test year period and therefore it would be inappropriate to adjust for accumulated depreciation for existing embedded plant. While this assertion is closer to the correct interpretation of Section 287.40, because it would acknowledge that accumulated depreciation for existing embedded plant is warranted at some point, it is still in error. The rule requires "all known and measurable changes in the operating results" to be accounted for in the pro forma adjustments, not just a subset of all of the changes the utility is performing.

ComEd's argument that accounting for accumulated depreciation for existing embedded plant in the post-test year period is attrition[58] is a fundamental misunderstanding of attrition. During periods of high inflation utilities sought adjustment to their rates for attrition. Basically, utilities defined attrition as "the adverse impact on return of the inevitable increases which continuously occur in levels of operating

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[54] *Supra*, §II.A. and *infra* §II.D.

[55] ComEd also argued that the AG's position was inconsistent with the 01-0423 Order. Since we, previously in this dissent, addressed the rationale relied upon by the Commission in the 01-0423 Order, there is no need to revisit that argument.

[56] 05-0597 Order at 13; *see also*, ComEd Reply Brief in Docket 05-0597 at 23.

[57] *See, supra*, §II.A. *explaining* that accumulated depreciation is a known and measurable change.

[58] 05-0597 Order at 13; *see also*, ComEd Reply Brief in Docket 05-0597 at 23.

expense and in levels of investment."[59] A couple of utilities expanded the definition above to account for instances in which the utility was not able to offset the increase with revenue and productivity gains.[60] In one case, a gas utility identified factors such as "weather and economic conditions, and fluctuations due to internal operating conditions."[61] The Bender Series also provides some guidance on the matter. The Bender Series states that, "the pattern of declining earning, caused by cost of service increasing more rapidly than revenues, commonly has been referred to as attrition."[62] An example used in the Bender Series is on point with the instant issue:

> A major contributor to the attrition problem is the addition of new facilities, because the current costs of facilities normally are at much higher levels than embedded average cost of existing facilities.
>
> Accordingly, any new plant additions at current cost levels will produce further increases in average costs, which will result in further earnings deterioration. Rates designed to cover the depreciation and carrying charges on a $100 unit obviously will not cover a $200 unit coming on-line to provide similar services. When new facilities are being added at current levels that exceed embedded average costs (a normal condition in a growing system after long periods of inflation), earnings will decline, and rate relief will be required.[63]

Therefore, it is clear that attrition is not related to depreciation but more related to inflationary factors.[64]

In reaching its conclusion in the 07-0241/07-0242 Order, the Commission relied upon the decision in the 05-0597 Order.[65] None of the arguments raised in the 07-0241/07-0242 Order are new and have been thoroughly addressed above.

This retrospective review of the Commission's decisions (in Dockets 01-0423, 05-0597 and 07-0241/07-0242, the decisions most often relied upon by utilities for not accounting for accumulated depreciation of existing embedded plant in the post-test year period) demonstrates that the Majority should not have continued to rely upon those cases in reaching its decision in the instant case.

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[59] *North Shore Gas Co.: Proposed general rate increase in natural gas service*, 1974 Ill. PUC LEXIS 9 at *8 (July 24, 1974); *North Shore Gas Co.: Proposed general increase in natural gas rates*, Docket 77-0376, 1978 Ill. PUC LEXIS 31 at *16-17 (April 12, 1978).

[60] *The Peoples Gas Light and Coke Co.: Proposed general rate increase in natural gas rates,* Docket 78-0076, 1978 Ill. PUC LEXIS 4 at *32 (Dec. 6, 1978); *North Shore Gas Co.: Proposed general increase in natural gas rates*, Docket 82-0189, 1982 Ill. PUC LEXIS 3 at *27 (Dec. 28, 1982).

[61] *Iowa-Illinois Gas and Electric Company: Proposed general increase in rates for electric service*, Docket 76-0140, 1977 Ill. PUC LEXIS 38 at *22 (Jan. 17, 1977).

[62] Bender Series at 8-2.

[63] *Id*., at 8-2 to 3.

[64] *See*, IIEC Reply Brief at 11-12.

[65] 07-0241/07-0242 Order at 16-17.

D. Not Recording Accumulated Depreciation of Existing Embedded Plant During the Post-Test Year Period Sends the Wrong Signal

As previously noted, the failure to record accumulated depreciation of existing embedded plant during the post-test year period, in which additional plant is being factored into rate base, provides a windfall for the utility and provides an opportunity for the utility to over earn between rate cases. This action clearly encourages other utilities to extend the duration of the test period as far as possible. Given this test year mismatch and potential to over earn, one would expect profit maximizing utilities to seek this type of treatment, and by ever increasing amounts.

The Commission is, in fact, witnessing just such a trend, in which utilities are increasing the test period over which they are requesting pro forma adjustments for capital additions and by increasing amounts. The chart from IIECs initial brief (at 16) demonstrates this trend:

UTILITY	UTILITY PROPOSED PLANT ADDITIONS	UTILITY PROPOSED ACCUMULATED DEPRECIATION	COMMISSION ACTION	PRO FORMA INCREASE
ComEd -- Dkt. 01-0423	Recognition of some plant additions in **6-month post-TY period**.	No recognition of offsetting growth in accumulated depreciation on rate base.	Utility proposal accepted.	$253 million[66]
IP -- Dkt. 01-0432	Recognition of all gross plant additions over **9-month period**, plus some later additions.	No recognition of offsetting growth in accumulated depreciation on rate base.	Recognition of growth in accumulated depreciation over period all gross plant additions accepted.	
Ameren -- Dkts. 02-0798, et al.	Recognition of significant post-TY gross plant additions [over **12-month** post-TY period].	No recognition of offsetting growth in accumulated depreciation on rate base.	Recognition of gross plant additions only to extent they exceeded growth in accumulated depreciation over same period, i.e. increase in net plant balance.	
ComEd -- Dkt. 05-0597	Recognition of all gross plant additions over **12-month** post-TY period.	No recognition of offsetting growth in accumulated depreciation on rate base.	Utility proposal accepted.	$300 million[67]
PGL -- Dkt. 07-0242	Recognition of all gross plant additions over 12-month [**17 mos**.] **post-TY period.**	No recognition of offsetting growth in accumulated depreciation on rate base.	Utility proposal accepted.	
ComEd -- Dkt. 07-0566	Recognition of all gross plant additions over **21-month** post-TY period.	No recognition of offsetting growth in accumulated depreciation on rate base and reduction in test year accumulated depreciation for post-TY costs of removal.	Utility proposal accepted.	$1.3 billion[68]

It is evident from this table that utilities are taking advantage of the Commission's failure to properly apply the rule, since the incentive provides utilities additional and unnecessary revenue. The preceding table demonstrates two things -- that utilities are

[66] 01-0423 Order at 42 (March 28, 2003).
[67] 05-0597 Order at 14, 15 (July 26, 2006).
[68] Order at 16, 28.

increasing both their post–test year period and dollar value of pro-forma additions, and, as ComEd has been increasing its post-test year period and additions, its rate base also increases. The Majority's failure to account for accumulated depreciation in the post-test year gives them additional revenue they can use. Since the amount of accumulated depreciation increases with time, a utility seeking to maximize revenue is incented to increase the duration of the post-test year period to the greatest extent possible.

ComEd sought to maximize its revenue by adjusting rate base by using gross plant instead of net plant. The Majority's decision in the instant case allows that to occur. The example below compares the rate base that would occur using the instant Order's accepted ComEd methodology, to the rate base that would result if accumulated depreciation of existing embedded plant in the post-test year period had been deducted from rate base, as appropriate. It graphically reveals that ComEd's methodology inflates rate base and the revenue requirement and results in rates that are not just and reasonable:

EXAMPLE

UTILITY elects to file for new rates on February 1, Year-3 so that the new rates will be effective January 1, Year-4. UTILITY uses historical Year 2 as its Test Year. With respect to its existing embedded plant (Asset-1), UTILITY's filing reflects $1,000 depreciation expense and $2,000 in accumulated depreciation. UTILITY also states that it will add $10,000 in plant additions in Year-3 (Asset-2) and $5,000 in Year-4 (Asset-3). All assets have a 10-year depreciable life. The annual depreciation expense is computed according to the following:

Asset-1 (existing embedded plant):	$10,000 / 10-year life =	$1,000
Asset -2 (plant additions):	$10,000 / 10-year life =	$1,000
Asset -3 (plant additions):	$5000 / 10-year life =	$ 500
Total Depreciation Expense		$2,500

The UTILITY's filing would reflect $2,500 in Depreciation Expense in the Statement of Operating Income. Using the methodology approved by the Majority in the instant docket, the UTILITY's rates would be set on the rate base reflected in Column (e):

Majority's Methodology

Description (a)	12-31-Year-2 Test Year Balances (Asset 1) (b)	(🡐 Year 3 Plant Additions 🡒) Pro forma Adjustment 2 (Asset 2) (c)	Pro forma Adjustment 3 (Asset 3) (d)	Total Rate Base (Eff. 1-1-Year 4) (e)
Gross Plant	$10,000	10,000	5,000	$25,000
Accumulated Depreciation	(2,000)	(1,000)	(500)	(3,500)
Net Plant	8,000	9,000	4.500	21,500
Less:				
Deferred Income Taxes				(1,000)
Total – Rate Base				**$20,500**

The Correct Methodology for computing the UTILITY's rate base showing the affect of the increase in accumulated depreciation on Asset 1 in Year 3 (column e) is the following:

Description (a)	12-31-Year-2 Test Year Balances (Asset 1) (b)	(🡐=Year 3 Plant Additions and Adjustments 🡒) Pro forma Adjustment 2 (Asset 2) (c)	Pro forma Adjustment 3 (Asset 3) (d)	Pro forma Adjustment 4 (Asset 1) (e)	Rate Base (Eff.1-1-Year 4) (f)
Gross Plant	$10,000	10,000	5,000		$25,000
Accumulated Depreciation	(2,000)	(1,000)	(500)	(1,000)	(4,500)
Net Plant	8,000	9,000	4.500	(1,000)	20,500
Less:					
Deferred Income Taxes					(1,000)
Total – Rate Base					**$19,500**

Under the Majority' Methodology, UTILITY's rates provide for the recovery of $1,000 in depreciation expense annually (related to Asset-1) from rates established by the Commission in its most recent rate order. Then UTILITY makes pro forma adjustments to add Assets 2 and 3 to rate base. However, the UTILITY does not account for the accumulated depreciation of embedded plant in Year-3 (i.e., omitting Pro Forma Adjustment 4 (see Correct Methodology)). The Majority Methodology is recognizing only part of the "known and measurable" accounting entry by recording depreciation expense but not accumulated depreciation on Asset 1 for the pro forma period. Only the $1,000 depreciation expense on Asset 1 is being recognized and recovered in rates, but the part of the entry that increases accumulated depreciation for the pro forma period is being ignored. Thus, Accumulated Depreciation is understated by $1,000 and rate base is also overstated by $1,000.

In the Correct Methodology, the Year-3 increase in UTILITY's accumulated depreciation (related to the embedded plant, Asset-1) is shown in Column (e). Under the Correct Methodology, the rate base of $19,500 is $1,000 less than the previous example that ignored the increase in accumulated depreciation on embedded plant ($20,500 - $19,500). Thus, the $20,500 rate base is overstated by $1,000 and therefore, the resulting rates are excessive.

In the above Example, the Year-3 pro forma adjustment period is limited to 12-months. However, in Docket No. 07-0566 the impact of ignoring the increase in accumulated depreciation on embedded plant is further magnified because the pro forma adjustment period is much larger -- 18-months (January 1, 2007 to June 30, 2008). Nonetheless, the overall effects are the same as those in the above example: ComEd's rate base is overstated and the resulting rates are excessive.

The methodology approved by the Majority should be discontinued because it is contrary to the clear language of the rule and long standing Commission ratemaking policy and generally accepted accounting principles. If the Commission implements its rules based on the clear language of Section 287.40 and the precedence of the 02-0798/03-0008/03-0009 Order the Commission would use net plant instead of gross plant for the post-test year period. This is consistent with the test year matching principle -- balancing revenues and expenses. If the Commission is not properly balancing costs and expenses the utilities receive a windfall and the rates are not just and reasonable. (*See* 220 ILCS 5/9-101) In this rate case, ComEd has improperly received a windfall from ratepayers because of the Majority's incorrect use of gross plant.

For all of the reasons set forth above, we respectfully dissent from the Majority's decision on this issue.